5-27-2009

T.J.T., Inc. v. Mori Appellant's Reply Brief Dckt. 35079

IN THE SUPREME COURT OF THE STATE OF IDAHO

T.J.T., INC., a Washington corporation,

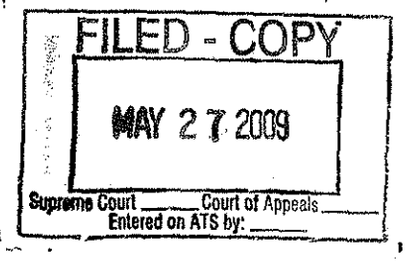
Plaintiff/Appellant,

vs.

ULYSSES MORI, an individual,

Defendant/Respondent.

Supreme Court No. 35079



APPELLANT'S REPLY BRIEF

Appeal from the District Court of the Fourth Judicial District
of the State of Idaho in and for the County of Ada

Honorable Ronald J. Wilper, presiding

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I. INTRODUCTION

Respondent Ulysses Mori cannot escape the central point of T.J.T., Inc.'s ("TJT") appeal from the district court's grant of summary judgment: the district court pre-tried TJT's claims at the summary judgment stage to conclude that the Non-Competition Agreement was unenforceable. Critical to the district court's conclusion was its factual determination that the business of Leg-it Tire Company, Inc. ("Leg-it") was "exclusively limited" to Northern California. ER 000232 (1/31/08 Order). Under California law, the location in which Leg-it conducted any phase of its business is also the location in which the non-compete at issue can be enforced. On the record before the district court and on appeal, the location in which Leg-it conducted any phase of its business is a hotly contested issue for which many issues of material fact exist. Indeed, on appeal, Mori ignores his own live testimony offered to the district court during the preliminary injunction hearing wherein he stated that the business of Leg-it was carried on in 11 Western states in 1997. *See* ER 000212-000213 (10/22/08 Tr. p. 26, L. 20 – p. 30, L. 20); *see also* ER 000216. As a result, the district court did what decades of appellate law warns against: it deprived a litigant of the right to a trial by weighing evidence and resolving factual disputes by way of a summary judgment proceeding.

Mori would also like to portray himself as a victim and hope the Court will ignore that he was handsomely paid $500,000.00 for the goodwill associated with the $1 million sale of the business of Leg-it. Along the same line, Mori attempts to minimize his role at TJT after consummating the Leg-it sale in 1997, but ignores that TJT—a publicly traded company—also gave Mori a seat on TJT's board of directors and Mori became responsible for day-to-day

management of the Woodland, California, facility as a senior vice president of TJT. ER 000007 (Verified Complaint ¶ 11); ER 000025 (Answer ¶ 12); ER 000048 (Deposition of Ulysses Mori ("Mori Depo.")), p. 47, L. 25 – p. 48, L. 5). Additionally, as TJT's President and CEO testified, "Ulysses Mori went wherever he was needed. He was a terrific troubleshooter. He was very busy all the time and he was – I miss him a lot." *See* ER SER00026 (Deposition of Terrence J. Sheldon, p. 49, LL. 18-20). These additional factual issues demonstrate that, when construed in the light most favorable to TJT, the evidence in the record does not warrant the entry of summary judgment. To the contrary, the record evidence presents a compelling case for the enforcement of the Non-Competition Agreement against Mori.

II. ARGUMENT

In his briefing on appeal, Mori liberally attacks the scope, breadth, and enforceability of the Non-Competition Agreement and even accuses TJT of becoming "greedy" in its effort to secure a non-compete ancillary to the sale of Leg-it. *See* Respondent's Brief at 1, 4, 12, and 14. The Court cannot overlook that Mori's law firm was on both sides of the transaction and was the very firm that drafted the Non-Competition Agreement at issue. *See* ER000223-225 (Letter from Howard Seligman to Paul Boyd). Now that TJT has different representation, all of the sudden it has become "greedy" and, curiously, the Non-Competition Agreement is worthless and unenforceable. Putting this aside, there can be no doubt that the Non-Competition Agreement is enforceable under California law.

A. The Non-Competition Agreement at Issue Is Governed by Business and Professions Code Section 16601.

Not surprisingly, Mori tries to cast the Non-Competition Agreement at issue as being governed by California Business and Professions Code Section 16600, which states "***Except as provided in this chapter***, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void." (Emphasis added.) Although Mori argues that California public policy prohibits "employment" non-competition agreements, Mori ignores that since before the turn of the 20th Century, California courts have also enforced non-compete provisions made ancillary to the sale of a business. *See Franz v. Bieler*, 126 Cal. 176 (1899) (enforcing covenant under predecessor to Section 16601); *see also Stephens v. Bean*, 65 Cal. App. 779 (1924) (same); *Mahlstedt v. Fugit*, 79 Cal. App. 2d 562 (1947) (same). Accordingly, the public policy in favor of allowing a party to enforce a covenant not to compete made ancillary to the sale of a business is equally as strong.

Mori makes note that covenants not to compete under Section 16601 are the exception, but that does not mean that such covenants are to be interpreted narrowly. In fact, under California law, "Covenants arising out of the sale of a business ***are more liberally enforced*** than those arising out of the employer-employee relationship." *Monogram Indus., Inc. v. SAR Indus., Inc.*, 64 Cal. App. 3d 692, 697, 134 Cal. Rptr. 714 (1976) (emphasis added). Moreover, under California law dating back to 1872, "[a]ll contracts, whether public or private, ***are to be interpreted by the same rules***, except as otherwise provided by this Code." CAL. CIV. CODE § 1635 (emphasis added). To interpret the Non-Competition Agreement any differently

would be inconsistent with California's long-standing public policy of fostering freedom of contract and of interpreting agreements in a manner that will make them enforceable, rather than, as against public policy. *See* CAL. CIV. CODE § 1643 ("A contract must receive such an interpretation as will make it lawful, operative, definite, reasonable, and capable of being carried into effect, if it can be done without violating the intention of the parties."); *see also Nw. Mut. Fire Ass'n v. Pac. Wharf Storage Co.*, 187 Cal. 38, 44 (1921) ("[I]f there is one thing more than another which public policy requires, it is that men of full age and competent understanding shall have the utmost liberty of contract, and that every contract, when entered into fairly and voluntarily, shall be . . . enforced by the courts of justice."). In fact, the *Monogram* court suggests that the covenant at issue here should be given more liberal enforcement given the amount paid to Mori for the goodwill of his former company.

B. Genuine Issues of Material Fact Exist as to the Location in Which Leg-it Conducted Business.

When it came time to offer Leg-it for sale in 1997, Mori demanded $1 million, even though its book value barely exceeded $500,000. *See* ER 000074-000075 (1997 Leg-it Balance Sheet); ER 000045 (Mori Depo., p. 35, LL. 6-9); ER 000046 (Mori Depo., p. 38, L. 12 – p. 39, L. 3); ER 000079 (Merger Agreement ¶ 2.1 at 4). Today, Mori takes a much different approach to claim that he was once touted as a tire and axle empire is now a lowly business with a small operation in Northern California. The record does not support Mori's newfound, but inconsistent claim. What Mori does not tell this Court is that he admitted in proceedings before the district court that, at the time of the merger in 1997, Leg-it did, in fact, also do business in

Oregon, Washington, Nevada, Idaho, Montana, Nebraska, Arizona, and Texas. *See* ER 000025 (Defendant Mori's Answer, ¶ 9). Additionally, during his deposition, Mori confirmed this admission in his answer. *See* ER 000043 (Mori Depo., p. 27, L. 1 – p. 28, L. 14). Mori also admitted in his deposition that the purchase of raw tires and axles in the above-identified states constituted at least 50% of Leg-it's business in 1997 and that the purchase of raw tires and axles is only one of the two components of the recycling business. *See* ER 000043 (*id.*, p. 24, L.22 – p. 25, L.2; p. 28, L. 15 – p. 29, L. 6).

During his deposition, Mori also ***admitted*** that he was competing with TJT in markets in which Leg-it operated in 1997:

> Q. You do admit that today you are competing with TJT; is that correct?
> A. ***I am doing sales for West States Recycling.***
>
> Q. Are you doing that in competition to TJT?
> A. ***West States Recycling is in competition with TJT.***
>
> * * *
>
> Q. (BY MR. WARD) ***You plan on continuing to compete in northern California, I presume***; correct?
> A. ***As long as the company directs me that way.***
>
> Q. ***You have contacted factories that are present customers of TJT in Idaho, Washington, and Oregon***; correct?
> A. ***And others, correct.***

See ER 000061 (*id.*, p. 99, LL. 3-10; p. 100, LL. 13-17) (emphasis added).

Against the weight of these repeated admissions, there is no support in the appellate record for Mori's attempts to create the false impression that Leg-it only did business in Northern California. The "business" must be taken as a whole and both aspects of the

"business" must be considered. Likewise, there is no weight to Mori's claim that the Non-Compete Agreement can be enforced only in Northern California because the clear record evidence demonstrates that Leg-it operated in numerous states and not just exclusively in Northern California. As demonstrated in TJT's opening brief, the place where Leg-it "mostly" conducted business is not the standard; rather, the question is whether Leg-it carried on some phase of its business in other states. Mori has not cited any case to this Court that suggests the enforceability of a non-competition provision is governed by a "qualitative" analysis that measures the extent to which business was carried on in a specific location. *Accord Monogram Indus., Inc. v. SAR Indus., Inc.*, 64 Cal. App. 3d 692, 702, 134 Cal. Rptr. 714 (1976) (stating that non-competition provisions are enforceable territories where the sold business conducted any phase of its business and enforcing non-competition provision in the United States, Puerto Rico, the U.S. Virgin Islands, and Canada).

Finally, Mori misleadingly cites *Kaplan v. Nalpak Corp.*, 158 Cal. App. 2d 197, 332 P.2d 226 (Cal. App. 1958), as requiring that a "substantial amount" of business be conducted. Mori is incorrect and misreads *Kaplan*. In *Kaplan*, the parties stipulated that a "substantial amount" of the sold business was conducted in certain locations; however, the *Kaplan* court never held that a prerequisite to enforceability to a non-compete is the existence of a substantial amount of business. *Id.* at 199. To the contrary, the *Kaplan* court held that the locations in which a "corporation's business 'has been carried on' within the meaning of section 16601 of the Business and Professions Code ***are not necessarily limited*** to those in which it has maintained plants, warehouses, stores or other physical structures." *Id.* at 200 (emphasis added).

As demonstrated below, the same holds true here, as the operations of Leg-it reached far beyond its physical plant location in Northern California.

C. Enforcement of the Non-Competition Agreement at Issue Is Not Limited to Northern California.

Mori appears to contend that if the Non-Competition Agreement is enforceable at all, it can only be enforced in Northern California because that is where Mori now says that Leg-it conducted "most" of its business. To support this argument, Mori attempts to shift the Court's focus away from the several states in which Leg-it actually conducted its business and attempts to downplay the significance of Leg-it's business outside of the state of California. Specifically, Mori states that "Leg-it had one facility, in Woodland, California, . . . and the recycled tires and axles were sold to approximately four or five manufactured home factories in Northern California and one factory in Colorado." *See* Respondent's Brief at 2. Mori also states that Leg-it "occasionally" made connections outside of California to procure raw tire/axles from dealers out of state. *Id.* at 2-3.

Mori's uses the term "occasional" to imply that these contacts were *de minimus*, notwithstanding his several admissions in the record that belie this assertion on appeal. Although Mori states that Leg-it "occasionally" purchased raw tires and axles in states outside of Northern California, he cannot credibly minimize the extent to which these contacts were necessary to Leg-it's business.

> Q. What was the area that you were covering by the time you sold to TJT in your dealer sales?
> A. It would basically fluctuate from time to time, but basically the area was ***California***, Reno, ***Nevada***, ***Oregon***, a little bit of

> ***Washington***, and over to – we actually got into ***Idaho*** and ***Montana***. That is where I would send my own trucks from time to time.
>
> Q. ***So you were operating in all of those states acquiring raw tires and axles***?
> A. ***Yes***.
>
> * * *
>
> Q. But ***the acquisition of tire and axles was a huge component of Leg-it's business***; was it not?
> A. ***Primary***.

See ER 000043 (Mori Depo., p. 27, L. 1 – p. 28, L. 14 (emphasis added)). Mori also admitted in his deposition that the purchase of raw tires and axles in the above-identified states constituted at least 50% of Leg-it's business in 1997 and that the purchase of raw tires and axles is one of the only two components of the recycling business. *See* ER 000043 (*id.*, p. 24, L. 22 – p. 25, L. 2; p. 28, L. 15 – p. 29, L. 6). Indeed, Mori admits in his respondent's brief that Leg-it's operations in Northern California facility were small, which further supports the significance of the extent to which Leg-it conducted business in other states because the purchase of raw tires and axles in these states was extremely important to Leg-it's business. Simply put, if Leg-it did not have any products to recycle, it would therefore not have any products to sell. In other words, this other key aspect of Leg-it's business admittedly carried on outside of Northern California was significant.

In light of the record evidence, there can be no doubt that Leg-it conducted business outside of the state of California, and specifically in Idaho, Oregon, and Washington, i.e., the very areas in which TJT seeks to enforce the Non-Competition Agreement. In

circumstances where a sold business conducted business in several locations, the California Court of Appeal has previously addressed the appropriate reach of a non-competition provision, stating:

> We hold that in the provisions of Business and Professions Code section 16601 the area where a business is "carried on" ***is not limited to the locations of its buildings, plants and warehouses, nor the area in which it actually made sales. The territorial limits are coextensive with the entire area in which the parties conducted all phases of their business including production, promotional and marketing activities as well as sales.***

Monogram, 64 Cal. App. 3d at 702 (emphasis added). As a result, the *Monogram* court enforced the non-competition provision in the United States, Puerto Rico, the U.S. Virgin Islands, and Canada, where the seller conducted business on a nationwide scale. *Id.* Although Mori would like the "conducting business" test to be limited to the place from which sales are made to its customers, the *Monogram* court makes clear that numerous other activities count for purposes of conducting business. The Court can easily do the same as it relates to the vast amount of business that Leg-it conducted outside of California.

And, Mori's inapposite analogies to pizza parlors, grocery stores, and other irrelevant lines of business offer no help in analyzing the issues before the Court. The businesses at issue in this case deal with a single commodity: tires and axles. Mori agrees that Leg-it *needed* to buy raw tires and axles in order to have a product to sell and that this was a "huge component" of Leg-it's business. *See* ER 000043 (Mori Depo., p. 28, LL. 11-14). Mori also overlooks the fact that Leg-it employees actually traveled into several states outside of California to procure the very same raw tires and axles that Leg-it ultimately sold to its customers. *See* ER

00043 (*id.*, p. 27, L. 20 – p. 28, L. 4) ("That is where I would send my own trucks from time to time."). Mori cannot ignore the essential elements of the tire and axle recycling business, nor can he credibly claim that he did not conduct the business of Leg-it outside of California. To the contrary, Mori has admitted that the "primary" aspects of the business of Leg-it took place in several locations outside of Leg-it's recycling facility in Woodland, California.

Consistent with *Monogram*, the territorial limits in which the Non-Competition Agreement can be enforced include the entire areas in which Leg-it conducted all phases of its business including promotional and marketing activities as well as sales. The undisputed record establishes that Leg-it "carried on" a significant phase of its business, i.e., the acquisition of raw tires and axles, in several states, including Oregon, Washington, Nevada, Idaho, Montana, Nebraska, Arizona, and Texas. Accordingly, the Non-Competition Agreement is enforceable in each of these states.

D. The Non-Competition Agreement at Issue Was Executed as Part of the Merger Between Leg-it and TJT and Is Therefore Governed by Section 16601.

Mori insinuates without directly stating that the Non-Competition Agreement should be invalidated because is was supposedly tied to Mori's post-merger employment with TJT. This argument ignores the nature and timing of the transaction between Leg-it and TJT, as evidenced by the undisputed documents before this Court. Under the clear record presented in this case, there can be no doubt that the Non-Competition Agreement is governed by Section 16601, as the agreement was made ancillary to the merger between Leg-it and TJT. But for the merger, there would have been no need for the covenant. Specifically, the plain language

of Section 4 states that Mori agreed not to compete with TJT "for the period ***beginning on the Effective Date*** and ending two (2) years following [Mori's] termination of employment with [TJT] . . . ." *See* ER 000113. The "Effective Date" of the Non-Competition Agreement is June 24, 1997, i.e., the same date Mori and TJT executed the Agreement and Plan of Merger. *Compare* ER 000111 (Non-Competition Agreement) *with* ER000076 (Agreement and Plan of Merger). Accordingly, the "term" of the Non-Competition Agreement is unquestionably tied to the date of the merger between TJT and Leg-it. Indeed, as one would expect, the Non-Competition Agreement was executed the very same day as the Agreement and Plan of Merger between Leg-it and TJT. *See* ER 000111; 00076.

In addition to the *timing* in which the Non-Competition Agreement was executed, the *terms* of the agreement eviscerate Mori's contention that the Non-Competition Agreement should be invalid because it simply uses Mori's employment as a trigger for when the non-compete goes into effect. Notably, the Non-Competition Agreement states:

> Seller acknowledges that:
>
> (c) **[TJT] has required that Seller make the covenants** set forth in *Sections 3* and *4* [noncompetition provision] hereof **as a condition of [TJT's] purchase of the Stock [of Leg-it]**;
>
> (d) the provisions of *Sections 3* and *4* [noncompetition provision] are reasonable and necessary to protect and preserve the business of Leg-it (as a division of [TJT]); and **[TJT] and its Leg-it Division would be irreparably damaged if Seller were to breach the covenants** set forth in *Sections 3* and *4* [noncompetition provision]; and
>
> (e) **the time, scope, geographic area and other provisions hereof have been specifically negotiated by sophisticated business persons**.

See ER 000112 (Non-Competition Agreement at 2) (bold emphasis added; italics in original). Stated simply, as a condition of paying Mori nearly a half a million dollars for the goodwill stock of his business, TJT required as part of this merger that Mori execute this covenant. Moreover, the non-competition provision at issue here states that Mori agreed to the non-compete as "an inducement for [TJT] to enter into the Merger Agreement and as additional consideration for the consideration to be paid to [Mori] under the Merger Agreement." ER000113.

Now that Mori refuses to uphold his end of the Non-Competition Agreement, he is looking for any way—whether based in fact or not—to avoid the clear enforceability of the non-competition provision. As the Non-Competition Agreement unequivocally states, the non-competition provision in Section 4 was a "condition of the purchase of Leg-it" and that the specific terms of the non-competition provision were "specifically negotiated by sophisticated business persons." This is not a relationship where there exists unequal bargaining power and the parties so acknowledged. Mori was represented by counsel in negotiations involving the Non-Competition Agreement. *See* ER000223-225. Mori received a half million dollars for the goodwill of his business that he grew and operated throughout the West. Under California law, a person cannot accept the benefits of a contract (accept a six-figure sum of money) and thereafter deny being bound by the contract (later seek to invalidate its provisions).[1] Mori cannot be allowed to use the Non-Competition Agreement to whipsaw TJT in this fashion.

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[1] *See, e.g., Avina v. Cigna Healthplans*, 211 Cal. App. 3d 1, 3 (1989); *Lemat Corp. v. Am. Basketball Assoc.*, 51 Cal. App. 3d 267, 275-277 (1975).

Additionally, the sole fact that TJT also chose to employ Mori upon purchase of his business does not change this result. Mori tries to ignore the true nature of the circumstances under which the Non-Competition Agreement was executed by pointing to the Employment Agreement also executed between Mori and TJT. In particular, Mori relies on a single provision from the Employment Agreement—its integration clause—which states that the Employment Agreement and the Non-Competition Agreement (defined as the "Employment Documents" in the Employment Agreement) contain the entire understanding of the parties. *See* SER00008 (Employment Agreement ¶ 2.5). Mori contends that the integration clause of the Employment Agreement somehow converts the true nature of the transaction, i.e., the merger and purchase of Leg-it by TJT, to a single employer-employee non-competition agreement. Notably, the Employment Agreement itself ***does not*** contain a non-competition agreement, and the integration clause simply states that the Employment Agreement and the Non-Competition Agreement executed on June 24, 1997, constitute the entire understanding between the parties. Importantly, the integration clause does not say what Mori wishes it says and does not say that the terms of the Non-Competition Agreement are incorporated by reference into the Employment Agreement. In any event, the reference to the Non-Competition Agreement in the Employment Agreement does not change the fundamental nature of the merger transaction that was executed on June 24, 1997, by TJT and Mori.

To further illustrate the differences between and purposes of the Employment Agreement and the Non-Competition Agreement, it is also important to note in what capacity Mori signed each respective document. Specifically, Mori signed the Non-Competition

Agreement as "Seller" of Leg-it, whereas Mori signed the Employment Agreement as "Employee" of TJT. *See* ER000118 (Non-Competition Agreement); SER00012 (Employment Agreement). Mori's execution of the Non-Competition Agreement as the "Seller" further underscores the nature of the transaction and the circumstances under which Mori and TJT entered into the Non-Competition Agreement. The covenant was a condition and ancillary to the sale of this business under Section 16601. Against this background, Mori's attempts to cast the Non-Competition Agreement as more akin to an employer-employee non-compete can be summarily rejected.

E. The Non-Competition Agreement at Issue Can Be Enforced Consistently with Business and Professions Code Section 16601.

In another effort to void the Non-Competition Agreement, Mori argues that the scope of the non-competition provision in Section 4 goes beyond what is allowable under California law. Specifically, Mori contends that the Non-Competition Agreement is overly broad because it does not prohibit Mori from competing in Northern California only. Mori claims that, at most, the Non-Competition Agreement should be limited to Northern California where Leg-it maintained a facility, and because the prohibited areas included other areas in which TJT conducted business, Mori contends that the entire Non-Competition Agreement is somehow unenforceable. Mori's arguments fail under California law. As demonstrated below, the California courts have a long history of enforcing non-competition provisions by tailoring the geographic areas to those in which the seller conducted business.

In support of this argument that the Non-Competition Agreement is unenforceable and cannot be tailored, Mori relies on *Strategix, Ltd. v. Infocrossing West, Inc.*, 142 Cal. App. 4th 1068 (2006). A careful reading of the *Strategix* case does not support Mori's position. And, *Strategix* is clearly distinguishable to the facts presented here. Moreover, a survey of California law reveals that the Non-Competition Agreement remains enforceable even if, on its face, the non-competition provision includes broad restrictions on territories in which Mori can compete.

1. Mori misplaces his reliance on *Strategix*.

To understand the manner in which Mori has misapplied *Strategix*, it is important to study the specific nonsolicitation covenant at issue in that case. Quite simply, *Strategix* involved the sale of a business by the seller, Strategix/ePassage, to a buyer, Infocrossing/SMS. *Id.* at 1071. The nonsolicitation covenants in *Strategix* prohibited the seller of the business from soliciting *the buyer's* employees and customers. *Id.* The buyer of the business ultimately sued the seller for violating the nonsolicitation of customers and sought injunctive relief. *Id.* The district court granted a preliminary injunction barring the seller of the business from soliciting the *buyer's* employees or customers. *Id.* at 1071-72. In reversing the district court, the California Court of Appeal concluded that the "courts may enforce nonsolicitation covenants barring the seller from soliciting the *sold business's* employees and customers." *Id.* at 1073 (emphasis in original). Because the covenant at issue in *Strategix* prohibited only the solicitation of the *buyer's* customers and not the *sold business's* employees and customers, the court of appeals held the covenant invalid. *Id.* at 1073-74.

The purchaser in *Strategix* requested the court of appeals to blue pencil the nonsolicitation covenants to address only the solicitation of the *sold business's* employees. *Id.* at 1074. The court of appeals refused to blue pencil the nonsolicitation covenants stating, "We decline to rewrite overbroad covenants not to solicit Infocrossing's [the buyer's] employees and customers into narrow bars against soliciting Strategix's [the sold business's] former employees and customers." *Id.* Accordingly, the reason the *Strategix* court refused to blue pencil the nonsolicitation covenants is because such covenants prohibited solicitation of ***only*** the buyer's customers and employees and, therefore, the covenants could not be *narrowed* in scope to be enforced against the seller's customers and employees. In short, the court of appeals simply chose not to completely rewrite the nonsolicitation covenants to prohibit solicitation of a completely new group of people, i.e., the sold business's employees and customers.

In support of his argument that the non-competition provision of Section 4 is overly broad and cannot be blue penciled, Mori argues that the covenant at issue in *Strategix* "purported to restrict the seller from soliciting the employees and customers of the entire buyer business, not just the former employees and customers of the seller business." *See* Respondent's Brief at 15 (emphasis omitted). However, a careful reading of *Strategix* reveals that the nonsolicitation covenants ***did not*** cover the employees and customers being sold and instead focused exclusively on solicitation of the buyer's employees and customers.[2] Indeed, the very

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[2] The California Court of Appeal described the covenants as follows:

> The consulting agreement contained two nonsolicitation covenants. One prohibited ePassage [seller] from soliciting SMS's [buyer's]

reason the court of appeals refused to blue pencil the nonsolicitation covenants is because such covenants did not include the sold business's customers and employees and, therefore, the covenants could not be "narrowed" in any fashion to be enforceable. As a result, the court of appeals refused to rewrite the nonsolicitation covenant and prohibit solicitation of the sold business's customers and employees.[3]

> employees for one year after the termination of the consulting relationship. The other prohibited ePassage [seller] from soliciting SMS's [buyer's] customers for the same period.

Id. at 142 Cal. App. 4th at 1071.

[3] To enforce the nonsolicitation provision in *Strategix* as requested by the buyer, the court of appeals would have had to write in words, as opposed to merely striking words, thus violating the blue pencil doctrine. Specifically, the provisions would be rewritten as follows:

> Section 5.4(b) – Customer Non-solicitation:
>
> ePassage [seller] agrees that during the term of this Agreement and for a period of twelve (12) months immediately following the termination of ePassage's relationship with the Company [buyer] for any reason, whether with or without cause, ePassage [seller] shall not, and shall cause its employees and agents not to, call on, solicit or service any **former** customer, supplier, licensee, licensor, consultant, or other trade related business relation of ~~the Company~~ **ePassage** in order to induce or attempt to induce such person or entity to cease doing business with the Company, or in any way interfere with the relationship between any such **former ePassage** customer, supplier, licensee, licensor, consultant or other trade related business relation and the Company (including, without limitation, making any disparaging statements or communications about the Company).

See 2006 WL 886991 at * 5 (Respondent's Brief filed in *Strategix, Ltd. v. Infocrossing West, Inc.*, dated February 23, 2006).

In comparison to the case at bar, the Non-Competition Agreement does not prohibit Mori from competing in areas solely where TJT does business or prohibit Mori from soliciting TJT's customers only. If it did, then the *Strategix* case *might* have some arguable applicability. Instead, the Non-Competition Agreement prohibits Mori from competing in territories where *both* TJT and Leg-it conducted business, as well as soliciting *both* TJT and Leg-it's customers. Because the Non-Competition Agreement contains broad language prohibiting competition in areas where *both* TJT and Leg-it carried on business, it can easily be "narrowed" to allow enforcement where just Leg-it conducted business. The same holds true with regard to the solicitation of Leg-it's customers. Thus, as demonstrated below, at the very minimum, the Non-Competition Agreement is enforceable to the extent it prohibits Mori from competing and soliciting customers in areas where Leg-it "carried on" its business.[4] The district

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[4] For example, the Non-Competition Agreement could be easily narrowed (as opposed to rewritten) as follows:

> 4. Noncompetition.
>
> As an inducement for the Company to enter into the Merger Agreement and as additional consideration for the consideration to be paid to Seller under the Merger Agreement:
>
> (a) For the period beginning on the Effective Date and ending two (2) years following Seller's termination of employment with the Company for any reason (such period being the "Term"):
>
> (i) Seller shall not . . . engage or invest in, own, manage, operate, finance, control, or participate in the ownership, management, operation, financing, or control of, *be employed by*, associated with, or in any manner connected with, lend Seller's name or any similar name to, lend Seller's credit to, or render

court erred by refusing to address this question, as California law permits a covenant not to compete to be "narrowed," so long as the covenant is not "rewritten."

2. For over a century, California courts have narrowed broadly worded non-competition provisions to allow enforcement in territories where the sold business was "carried on."

A review of California law suggests that, had the nonsolicitation covenants in *Strategix* covered the sold business's employees and customers and the buyer's employees and customers, the court of appeals could have blue penciled the covenants to prohibit only the solicitation of the sold business's customers and employees.

For example, California courts have long enforced overbroad non-compete provisions to the extent that they were properly enforceable. In *Franz v. Bieler*, 126 Cal. 176 (1899), the California Supreme Court enforced, pursuant to Section 16601's predecessor, a non-compete provision in which the defendant agreed he would not engage in the wine and liquor business "within the radius of ten miles in either direction from 809 East Fourteenth street, in the city of Oakland, for the period of 10 years." *Id.* at 180. The defendant argued that the provision was invalid, because the described area included three separate counties. The supreme court, however, found that the exact territory being described was ascertainable, and the agreement was

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> services or advice to, any business whose products or activities compete in whole or in part with the products or activities of ~~the Company and/or~~ Leg-it, anywhere within 1000 miles of any facility owned or operated by ~~the Company or~~ Leg-it; . . . .
>
> * * *

ER000113 (Non-Competition Agreement) (emphasis added).

enforceable to the extent the property fell within the county where the defendant conducted business. The supreme court explained "that the inclusion of territory greater than that sanctioned by the code ***is void only as to the excess***." *Id.* at 181 (emphasis added).

Similarly, in *Stephens v. Bean*, 65 Cal. App. 779 (1924), the California Court of Appeal enforced an agreement prohibiting an undertaker, who had sold his one-half interest in an undertaking business, from forever competing with the purchaser, despite the lack of either a geographical or temporal limitation in the agreement. The court of appeal concluded that the business was local in nature and that the city and county in which it was located was apparent from the agreement. The court of appeal further noted that the general prohibition against non-compete provisions (currently Section 16600) stated only that a contract not in accordance with the provisions of that chapter "is to that extent void" and not wholly void. *Id.* Therefore, to the extent that the agreement did comply with Section 16601's predecessor, it was valid and enforceable.[5]

In *Mahlstedt v. Fugit*, 79 Cal. App. 2d 562 (1947), as in *Stephens*, the California Court of Appeal enforced an agreement under Section 16601 that contained no geographical limitation at all. In *Mahlstedt*, the seller of a heater business agreed not to enter into that business as a manufacturer, owner, or salesman for 10 years. The seller later argued that the agreement was void, because it did not contain a geographical limit, as required by Section

[5] Moreover, as far back as 1934, the California Supreme Court expressed the policy in California that courts should try to find ways to enforce otherwise valid noncompete provisions, "the courts will now strain to put such a construction upon the covenant so as to save it in part." *Edwards v. Mullin*, 220 Cal. 379, 382 (1934).

16601. *Id.* at 566. The court of appeal, however, found that a contract with no geographical limit will be enforced to the extent permitted by law. Because the heating business was located in Los Angeles County, the court prohibited the seller from competing with the entire county.

In *Mahlstedt*, the California Court of Appeal succinctly stated the rules regarding enforcement of non-competition provisions made ancillary to the sale of a business:

> On the date of the contract sections 1673 and 1674 of the Civil Code were in effect. (These provisions with slight modifications are now sections 16600 and 16601 of the Business and Professions Code.) As authorized by said sections of the Civil Code appellant, having transferred the good will of his business, agreed to refrain from carrying on a similar business for a period of ten years. He contends that that portion of his agreement was void because it did not, as required by section 1674, specify the territory within which he agreed not to carry on his business. ***If such a contract is indefinite as to time or territory the court will construe it in such manner as to make it valid. If the contract is unrestricted as to the territory in which the seller agreed to refrain from competition with the purchaser of his business, or if it includes more territory than that provided by law it will be construed to be operative within the county or portion thereof in which the business is located*** (*City Carpet etc. Works* v. *Jones,* 102 Cal. 506, 512 [36 P. 841]; *Stephens* v. *Bean,* 65 Cal. App. 779, 783 [224 P. 1022]; *General Paint Corp.* v. *Seymour,* 124 Cal. App. 611, 614 [12 P.2d 990]), and if the agreement is indeterminate as to the period of its operation, or is without time limit, the court will construe it to cover the time permitted by law. (*Gregory* v. *Spieker,* 110 Cal. 150, 153 [42 P. 576, 52 Am.St.Rep. 70]; *Brown* v. *Kling,* 101 Cal. 295, 298 [35 P. 995].)

79 Cal. App. 2d at 566-67 (emphasis added); *Kolani v. Gluska*, 64 Cal. App. 4th 402, 407-08, 75 Cal. Rptr. 2d 257, 259-60 (Cal. App. 1998) (stating in dictum that several courts have "saved" covenants not to compete which were valid under § 16601, but simply overbroad in scope).

It is important to note that, in *Strategix*, the California Court of Appeal in no way overruled the vast body of California law summarized above in *Mahlstedt*. Indeed, the *Strategix* court cited *Mahlstedt* in recognizing that "Courts have 'blue penciled' non-competition covenants with overbroad or omitted geographic and time restrictions to include reasonable limitations." 142 Cal. App. 4th at 1074. Accordingly, the result in *Strategix* appears to be limited to the specific facts presented in that case.

Against the clear weight of California law, even if the Non-Competition Agreement encompasses a territory that cannot be protected from competition along with a territory that can be protected, that does not mean, as Mori has argued, that the Non-Competition Agreement is unenforceable. Instead, as demonstrated below, the Non-Competition Agreement specifically captures territories where Leg-it conduced business prior to the merger in 1997. Accordingly, at a minimum, the Non-Competition Agreement is operative in the areas in which Leg-it conducted business.

Moreover, with regard to Mori's claim that the Non-Competition Agreement cannot be enforced because TJT is trying to enforce the agreement ten years after Leg-it was sold, there can be no doubt that the California courts have enforced non-competition provisions with a term of ten years. *Franz*, 126 Cal. at 180; *Mahlstedt*, 79 Cal. App. 2d 562 at 566. Indeed, in a case involving a non-competition provision of infinite duration, the California Supreme Court tailored such provision to apply for as long as the purchaser carried on a similar business. *See Martinez v. Martinez*, 41 Cal. 2d 704, 706 (1953). In light of these authorities, TJT's efforts to enforce the Non-Compete Agreement are not impacted by the passage of time. TJT paid

nearly a half-million dollars in consideration for the Non-Competition Agreement and such agreement was not without value *until* Mori terminated his relationship with TJT.

Finally, as for Mori's intensely fact-driven argument that Leg-it has no more goodwill to protect, such argument can be rejected based on the very authority upon which Mori relies in his opposition brief. Specifically, in *Strategix*, the California Court of Appeal noted that Section 16601 covenants "prevent the seller from unfairly depriving the buyer of the full value of its acquisition, *including* its goodwill." 143 Cal. App. 4th at 1072 (emphasis added).[6] Accordingly, the touchstone under California law is preventing a seller from depriving the buyer of the full value of its acquisition, which merely includes goodwill. Even if Leg-it has no more goodwill to protect—a contested factual issue that cannot be foreclosed at the summary judgment stage—the absence of goodwill does not render the Non-Competition Agreement unenforceable. By openly competing with TJT in areas where Leg-It previously did business in violation of his Non-Competition Agreement, Mori is unquestionably depriving TJT of the full value of the $1 million consideration that it paid as part of the Leg-it merger. As a result, the Non-Competition Agreement must be enforced.

F. In Seeking Attorney's Fees, Mori Cannot Simultaneously Invalidate and Invoke the Provisions of the Non-Competition Agreement.

Mori relies on California Civil Code Section 1717, which provides that contractual prevailing party attorney fees provisions must be mutual, i.e., both sides must be able

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[6] "At common law, a restraint against competition was valid to the extent it reasonably provided protection for a valid interest of the party in whose favor the restraint ran." *Vacco Indus., Inc. v. Tony Van Den Berg*, 5 Cal. App. 4th 34, 47-48, 6 Cal. Rptr. 2d 602 (1992).

to enforce such provisions. Mori claims that he is entitled to attorney's fees pursuant to Section 1717 even though he successfully convinced the district court that the Non-Competition Agreement is void—and therefore illegal—under the prohibition against employer-employee non-competes stated in California Business and Professions Code 16600. The authorities cited in TJT's opening brief squarely state why Section 1717 has no application here. *See* Opening Brief at 36-40, citing *Geffen v. Moss*, 53 Cal. App. 3d 215 (1975); *Bovard v. Am. Horse Enters., Inc.*, 201 Cal. App. 3d 832 (1988). Specifically, in *Bovard,* the court of appeal stated:

> Ordinarily, in an action on a contract which provides for an award of attorney's fees, the prevailing party in the action is entitled to attorney's fees. (Civ. Code, § 1717, subd. (a).) This is so even when the party prevails on grounds the contract is inapplicable, invalid, unenforceable or nonexistent, if the other party would have been entitled to attorney's fees had it prevailed.
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> * * *
>
> ***However, a different rule applies where a contract is held unenforceable because of illegality.*** *Geffen v. Moss* (1975) 53 Cal. App. 3d 215 is directly on point. In that case, the court held a party may not recover attorney's fees when it successfully defends an action on a contract on the ground the contract violated public policy.

201 Cal. App. 3d at 842-43 (emphasis added). Because the district court held the Non-Competition Agreement to be illegal as a result of Mori's arguments, Mori cannot invoke Section 1717.[7]

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[7] If there was any room for argument as to the impact of this Court's finding that the non-competition agreement is void, that argument was recently unequivocally addressed in *Edwards v. Arthur Andersen LLP*, 44 Cal. 4th 937, 946, 189 P.3d 285, 289 (Cal. 2008), wherein the California Supreme Court stated, "In sum, following the Legislature, this court generally condemns noncompetition agreements . . . such restraints on trade are '***illegal***.'" (Emphasis

For the same reasons, Mori's reliance on *Yuba Cypress Hous. v. Area Developers*, 98 Cal. App. 4th 1077 (2002), is misplaced. Mori devotes an entire section of his Respondent's Brief to contend that the Non-Competition Agreement was tied to Mori's employment with TJT, not the goodwill of Leg-it. *See* Respondent's Brief at 16-18. The point of this argument appears to be that Mori wants to leave the Court with the impression that the Non-Competition Agreement is nothing more than an illegal contract that bans the pursuit of a lawful profession, trade, or business. At the same time, when it comes time to uphold the Non-Competition Agreement for the sole purposes of extracting legal fees from TJT, Mori argues that the Non-Competition Agreement did have a lawful object insofar as it was made ancillary to the sale of a business. Specifically, Mori argues that "the facts of this case are distinguishable from *Bovard* and *Geffen* [because] Mori and TJT were not entering into a non-compete agreement whose very object was illegal. The parties entered into the sale of a business and their object in creating a sale of business non-compete was not illegal." *See* Respondent's Brief at 30. Mori's argument contravenes the holding of the district court, which concluded that the term of the Non-

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added.) And, despite Mori's plea to the contrary, it has long been the law in California that non-competition agreements in violation of the provisions of Section 16600 are illegal. Thus, the object of an agreement that violates Section 16600 is indeed an illegal object. *Advanced Bionics Corp. v. Medtronic, Inc.*, 29 Cal. 4th 697, 706, 59 P.3d 231, 237 (Cal. 2002) ("We have even called noncompetition agreements illegal"); *Armendariz v. Found. Health Psychcare Servs., Inc.*, 24 Cal. 4th 83, 123, n.12, 99 Cal. Rptr. 2d 745, 6 P.3d 669 (2000) (noting that contracts that violate Section 16600 are "illegal"); *Kolani v. Gluska*, 64 Cal. App. 4th 402, 407-08, 75 Cal. Rptr. 2d 257, 259-60 (Cal. App. 1998) (contracts that violate Sections 16600 and 16601 are "illegal"); *Application Group, Inc. v. Hunter Group, Inc.*, 61 Cal. App. 4th 881, 889, 72 Cal. Rptr. 2d 73, 77-78 (Cal. App. 1998) (referencing trial court's finding that covenant that violated Section 16600 was "illegal").

Competition Agreement was tied to Mori's employment and was therefore void pursuant to Section 16600. ER 000233-000234 (1/31/08 Order). Embedded in this determination is the district court's conclusion that the Non-Competition Agreement was more akin to an "employment" non-compete that was illegal under California Business and Professions Code Section 16600, as opposed to a non-compete made ancillary to the sale of a business. *Id.* Mori's arguments on appeal simply contradict the findings of the district court that the covenant at issue is an illegal covenant prohibited by Section 16600.

G. Idaho Law Does Not Govern the Award of Attorney's Fees.

The parties to the Non-Competition Agreement selected California law to govern the agreement by use of the following language: "This Agreement shall be governed by, construed, interpreted and applied in accordance with the laws of the State of California, without giving effect to any conflict of laws rules that would refer the matter to the laws of another jurisdiction." *See* ER000115 (Non-Competition Agreement ¶ 10(a)). The Idaho courts recognize and enforce contractual choice of law provisions in both commercial and non-commercial settings. *See Great Plains Equip., Inc. v. Nw. Pipeline Corp.*, 132 Idaho 754, 765, 979 P.2d 627, 628 (1999). As a result of the broad reach of this provision, there is absolutely no need or occasion to look to Idaho law in determining whether attorney's fees should be awarded. When Mori and TJT executed the agreement, they unquestionably agreed that California law would control all aspects of the Non-Competition Agreement. Against this background, the district court incorrectly found that both California and Idaho law would allow for the recovery of attorney's fees and therefore concluded that a choice of law analysis was not necessary. *See*

ER000272 (11/21/08 Order). As demonstrated above, under the rule stated in *Bovard* and *Geffen*, California law does not permit an award of attorney's fees. In light of the choice of law provision in the Non-Competition Agreement, the inquiry ends there.

Mori contends that, even though the parties selected California law to govern all aspects of the Non-Competition Agreement, somehow Idaho Code Section 12-120(3) should apply here. In order to prevail on this argument, Mori must establish that the parties to the Non-Competition Agreement intended to carve out a limited "attorney's fees exception" to the choice of law provision (paragraph 10(a)), which clearly identifies that that California law will govern. At a minimum, the parties' intent to apply any other law than the state of California to all aspects of the Non-Competition Agreement is a factual issue that should have been developed in the district court. The same holds true for any choice of law analysis to be conducted in relation to an award of attorney's fees.

Finally, *Ward v. Puregro Co.*, 128 Idaho 366, 913 P.2d 582 (1996), is distinguishable from the facts presented here. In *Ward*, there is no indication that a conflict between Idaho and California law existed; as a result, the Idaho Supreme Court did not undertake a choice of law analysis to determine if a conflict existed. Accordingly, the Idaho Supreme Court's award of attorney's fees under Idaho law may not have offended or even conflicted with the parties' inclusion of the California choice of law provision in their settlement agreement. Thus, *Ward* bears little on the parties' dispute over attorney's fees in this case. Notwithstanding the application of Idaho law in *Ward*, when presented with a binding choice of law provision selecting a particular state's law to govern, courts look to the law of such state to govern all

aspects of the dispute, including the award of attorney's fees. *See, e.g., Fiedler v. Bowler*, 117 Or. App. 162, 166, 843 P.2d 961, 963-64 (Or. Ct. App. 1992) (enforcing parties' Indiana choice of law provision and applying Indiana law to disallow an award of attorney's fees); *Telco Leasing, Inc. v. Transwestern Title Co.*, 630 F.2d 691 (9th Cir. 1980) (holding that district court committed plain error because it applied California contract law on the issue of attorney's fees despite the parties' explicit and valid contractual choice of law clause selecting Illinois law).

H. The Record Does Not Indicate That the District Court Considered All Factors Under Idaho Rule of Civil Procedure 54(e)(3) in Awarding Attorney's Fees.

The attorney's fees awarded in this case exceed six figures. Mori makes several references to the fact that the district court awarded "some" but not all of Mori's requested fees. The Court should not be misled by Mori's statements, as Mori received all but $2,926.00 of the total fees and costs he requested. *See* ER000268 (6/2/08 Order). For all intents and purposes, Mori received *everything* that he requested by way of attorney's fees and costs and cannot credibly claim otherwise. To uphold the award of fees, Mori accurately cites this Court's decision in *Parsons v. Mutual of Enumclaw Insurance Co.*, 143 Idaho 743 (2007), but misapplies the holding of that case in relation to the facts presented here. In *Parsons,* this Court stated that when a district court awards attorney's fees, the record must clearly indicate that the district court considered all factors under Idaho Rule of Civil Procedure 54(e)(3). Although TJT did focus considerably on the unreasonable amount of time spent by Mori's attorneys in defense of this case (including, for example, the expense of $11,450.00 to prepare Mori's answer to TJT's complaint), that does not change the fact that the district court failed to consider all factors under

Rule 54(e)(3) prior to granting Mori's attorney's fees in excess of $100,000.00. The record before this Court does not clearly show whether the district court considered all of the Rule 54(e)(3) factors and, therefore, the district court committed error.

III. CONCLUSION

For the foregoing reasons, TJT respectfully requests this Court to reverse the district court's grant of summary judgment to Mori, to grant partial summary judgment in favor of TJT, and to reverse the district court's award of attorney's fees to Mori.

DATED this 27th day of May, 2009.

MOFFATT, THOMAS, BARRETT, ROCK & FIELDS, CHARTERED

By _____
John C. Ward – Of the Firm
Attorneys for Plaintiff/Appellant

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 27th day of May, 2009, I caused a true and correct copy of the foregoing **APPELLANT'S REPLY BRIEF** to be served by the method indicated below, and addressed to the following:

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